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MORTGAGE MARKET DYNAMICS IN AN ERA OF CONTROLS

EXTRAPOLATION is a word seldom encountered except in the pseudo-scientific fiction magazines. Outside of scientific fiction, to extrapolate means to plot or imagine a situation that does not as yet exist, on the basis of one that does exist. Based on empirical calculations it might be termed in colloquial English "doing it with mirrors." That is just what the leaders of the building and real estate industries are doing when they predict that the continuation of Regulation X will bring about a paralysis of home building, undermind the mortgage business and deprive thousands of families of the right to buy a house. To negate this extrapolation one has only to turn to the record.

Certainly there has been a moderate slowing down in home building and real estate activity, and a collateral decline in mortgage financing, but this is the target on which the Federal Reserve System set its sights when it imposed the regulations. Regulation X provided a badly needed brake on loose housing credit and it helped to temper the inflationary program of home building.

Since the first of the year to the end of July housing starts (669, 500) have been greater for this seven-month period than in any year except the boom year of 1950. Home mortgage recordings of $20, 000 or under at the end of June were within 9. 8 percent of the heavy recordings for the last six months of 1950, and for the first quarter of 1951 home mortgages actually processed fell behind the previous quarter only 10 percent. These statistics indicate that Regulation X has not impaired home building and home financing as seriously as its opponents like to claim. In fact, it is not inconceivable that by the end of the year housing starts may come nearer to 1, 000, 000 dwelling units than the 850, 000 set as a target by Administrator Raymond M. Foley of HHFA. However, the key to the level of home building in 1951 is the number of housing starts financed with conventional loans or cash.

Home builders were so long pampered and favored by agencies of the Federal government that they are likely to forget that the industry could be expendable in a time of national emergency. The assaults of this industry on Regulation X make it easy to spot the termites in the American grain. A fast-paced building program, outside of a few defense areas, is no longer needed to stimulate a sagging economy as it was two years ago, but builders and real estate men are reluctant to rationalize the inflationary effects of a large-volume building program supported by easy mortgage credit. Embracing seduction by cliche they adopt the self-intoxicating press-agency that beats the tom-toms for production to the

exclusion of calculations on the actual impact of production. Being put off the gravy train is hard for them to take.

The political pressure to ease Regulation X restrictions is strong. It includes builders, building material men, Realtors and some mortgage bankers, all of whom wield wide influence in their respective communities. The pressure is heavy, too, from organized labor led by Walter Reuther of the United Auto Workers. However, the arguments of those opposed to the restrictions of Regulation X can be breached with facts, at least as persuasive to the contrary, if not more so.

The keynote of the attacks on Regulation X we most often hear is that the government is limiting home buying to the well-heeled only and snatching home ownership out of the reach of hundreds of thousands of families to curb inflation. It is further argued that these prospective home buyers are being deprived of their right to buy a home while those with ample cash are left free to do as they wish.

This is, of course, unadulterated claptrap! No would-be home owner without funds has an inherent right to purchase a house he cannot pay for on a "shoestring." The cash down payment on the percentage basis prescribed by Regulation X is no more, if as much, than is asked by most lenders on a so-called conventional loan. A larger loan than that is hazardous, and when it is insured or guaranteed, that is wrapping up a subsidy in the package for which in the long run the taxpayer may have to settle. That is something the citizen has no right to expect.

New dwelling units placed under construction in the first seven months of this year were 21 percent less than in the comparable period of 1950. This new construction very largely represents housing for which financing commitments were made before the imposition of government credit controls. It is probable that what restraint Regulation X and its companion curbs are having on home building is overestimated. In fact, it is likely that if the regulations were the only force operating to cut back home building, starts would be well ahead of the present total. The dominant factor curtailing housing production is the rising cost of money everywhere because of the Federal Reserve's withdrawal from the support of government bonds; while interest rates reflect the turnabout in the money market, Federal Housing Administration and Veterans Administration mortgage rates remain frozen at 4-1/4 and 4 percent, respectively. It would appear that the pinch of firm credit controls and tightness in mortgage money will cause a slow dwindling in housing production during the remainder of the year, but the over-all cut for 1951 does not look too threatening.

Home building is being adequately financed in some areas and in others mortgage money is hard to find. Loans for projects of several hundred houses at one time are difficult to finance, while loans for the construction of, say, twenty houses or less are readily available in most areas, providing the houses are in the wanted price brackets and suitable for the neighborhood in which they are to

be built. One benefit of the regulations has been to weed out many speculative builders and opportunists who are unable to cope with the credit restrictions and the temporary tightness of mortgage money. As a result, established builders are having less trouble in obtaining mortgage loans.

Of the factors influencing the investment of mortgage money none is more propulsive than interest rates. It has been said on good authority that the nation's home mortgage markets are affected by changes in general interest rates perhaps to a greater extent than any of the other money markets. Be that as it may, interest rates must have a free play in the market if there is to be any measuring of the demand for money in relation to the supply, and if demand and supply are to be balanced. Last March by a dramatic change in government fiscal policy interest rates were taken out of the strait jacket which had incased them for more than a decade. The only way interest rates were held at their former fixed levels was through the manipulation of the supply of money, and this manipulation meant the monetizing of government debt to expand the volume of money. This has always been a vulnerable position and in these parlous times

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CORRECTION:

The 13th line of the third paragraph p 417 should read "homes costing from $10,000 to $12,000" rather than "$10,000 to $20,000."

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Whenever a change in policy is made by our fiscal and monetary authorities, someone gets slapped . . . and in this change it is the mortgage industry which is shaken to its withers, particularly that segment of it which lends money on insured and guaranteed loans where the interest rates are fixed by action of the Federal government. With FHA and VA interest rates remaining unchanged, the disparity in the yield between a long-term government bond and a government-backed mortgage is such that the latter is generally not acceptable to the market.

Interest rates are currently the subject of many arguments punctuated with tabasco-flavored comments. I have heard over and over again that FHA and VA loans carry an artificially low interest rate and that it is inevitable they have

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Let's have a look at the significance of what has happened. Perhaps the most significant thing in respect to interest rates was the action taken by the Federal Reserve in March to extinguish its pegged price support of the government bond market and let supply and demand in the money market work. Equally significant was the announcement by the United States Treasury at practically the same time offering nontransferable 2-3/4 percent long-term bonds in exchange for outstanding restricted $2\frac{1}{2}$ percent issues. As I get the picture, two ends were served by these changes. One was to let government securities seek their own level in a free market and the other to promote the retention of long-term government bonds in the portfolios of institutional investors. Unquestionably the new policy takes a vital link out of the inflation chain because the effect is to demonetize government bonds.

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got to be increased. It has been pointed out to me logically and persuasively how illogical it is for the government to hold GI loans at 4 percent on the one hand and unpeg government bonds on the other. I have sat in on acrimonious debates over the political angles and how they are definitely overplayed. These fervent arguments for higher interest rates on FHA and VA mortgages, VA particularly, are all very convincing and earnest but it just ain't goin' to happen.

It is quite generally known, I suspect, that what takes place at the Veterans Administration in Washington is pretty largely determined by the action of the Federal Reserve Board; and there is no available information indicating that the Federal Reserve System would approve a higher rate of interest on VA loans, or FHA loans for that matter. Two years ago the Federal Reserve stopped the $4\frac{1}{2}$ percent maximum interest rate on VA loans, passed by Congress, from being effective by advising the Secretary of the Treasury that such an increase would be inflationary and detrimental to the economy. The Federal Reserve System is just as important a factor now as it was then and there is no reason to think its attitude has undergone a change. Furthermore, Congress set up $150, 000, 000 for direct 4 percent loans to veterans by the Veterans Administration if a veteran could not obtain a mortgage loan at 4 percent in his own area. Hence you have very concrete proof of Congressional purpose that GI loans were to bear an interest rate of 4 percent and, by the same token, that 4 percent was a fair and moderate rate of interest.

Raymond M. Foley, Housing and Home Finance Administrator, is head of the Federal National Mortgage Association which has an investment in insured and guaranteed loans of $1, 500, 000, 000 or thereabouts. It could hardly be expected that Mr. Foley would approve an increase in interest rates on FHA and VA mortgages when such an increase would leave "Fanny May" holding a bundle of frozen 4 percent paper against new loans being made carrying a rate of probably $4\frac{1}{2}$ percent. Thus, of necessity, this $1, 500, 000, 000 investment is a mighty persuasive argument for Mr. Foley not to go along with a higher rate of interest for FHA and GI loans.

Now for the big reason, the one with the "Sunday punch," why interest rates on government-backed loans won't be increased . . . it's not politically expedient! The web of politics is festooned all over the issue and with an election year coming up in 1952, and millions of veterans' votes to reckon with, politicians have to be practical.

Now let us consider for a moment the participation of the Federal government in the mortgage business by direct loans. It is obvious that VA loans are shunned and little wanted; and with interest rates frozen at 4 percent, there appears small chance, if any, that this will change. It is equally obvious that unless a certain amount of funds is made available to veterans at 4 and 4-1/4 percent, the Veterans Administration will unquestionably put considerably more emphasis on its direct lending program. Thus far some 6, 500 GI's have taken advantage of these direct mortgage loans for an aggregate of over $63, 000, 000, and new applications are coming in at the rate of about 4, 000 monthly.

Government officials assert that a large volume of necessary defense and military housing is being halted by the unwillingness of lenders to extend to builders the requisite credit for such construction. Under this incentive the RFC with the sanction of Secretary of the Treasury Snyder and Secretary of Commerce Sawyer, have announced formally that it will commence granting credit for this type of housing where private loans are unavailable at moderate terms. While it is highly doubtful that the RFC is seriously headed for a major operation in home financing, its new policy is a mailed fist in a velvet glove poised to strike unless private lenders overcome their reluctance to finance housing for defense workers and military servicemen. Nothing could be more repugnant than a vastly extended program of direct lending, but under the circumstances it begins to look rather inevitable.

Moreover, if I am to be completely candid I must introduce another dour note at this point. The secondary market for FHA and VA mortgages has truly gone with the wind and with it went the day of premiums on these loans. In the light of what has happened it is not unclear that the mortgage bankers stand at the lich gate of premiums on insured and guaranteed loans. They might be resurrected at some time in the future when there is another scale of values, but it would be better for mortgage men to forget premiums altogether and return to the sound practice of charging borrowers a fee for services rendered.

With so much thrashing around over the shortage of mortgage money there is persistent talk that the home mortgage field is drying up. What the mortgage industry is encountering is a situation contrived by the Federal Reserve Board to restrict the supply of mortgage funds and slow down the building program. Stories that the bottom has dropped out of the home mortgage market are not true, but it is true that in many sections of the United States there is not enough new money internally generated by banks and other institutional lenders to provide borrowers with funds to carry through all the things they would like to do. However, it is probable that this credit urgency will be somewhat relieved now that President Truman has signed the new defense housing bill liberalizing credit regulations and intended to encourage private construction of moderately priced homes. Homes costing $12, 000 or less are involved chiefly in the new credit regulations. On homes costing from $10, 000 to $20, 000 the new regulations permit veterans to make down payments of 8 percent and non-veterans 20 percent. On homes in the $7, 000-$10, 000 category non-veterans will be called upon to pay down up to 15 percent and veterans 6 percent. On homes costing $7, 000 or less the new down payments will be 10 percent for non-veterans and 4 percent for veterans.

The early part of the summer there was a two-day meeting held in New York City under the sponsorship of the Architectural Forum which drew builders and mortgage men from all over the nation who came to talk about the problems of the present situation: and from the drop of the hat it was clear that the pinch for mortgage money depended wholly on the part of the country from which the operator came. Having had something of the same idea for several months we did a bit of probing around on our own and the results confirmed our preliminary observations

that the severity of the mortgage money shortage hinged almost entirely on location. To emphasize this point permit me to quote from the recent letter of an executive of a large New England bank: "Activity is just as heavy as ever and as a matter of fact, we are besieged on all sides by developers and builders for construction funds. In our own particular shop here our deposits are rising and we have not really felt the need for a strict curtailment of mortgage lending."

Now turning attention briefly to the Federal National Mortgage Association, familiarly known as "Fanny May," since last spring the submission of mortgages to Fanny May has increased at such a rate that some observers are wondering if the agency might again go out of the market. Administrator Foley has publicly said that to the best of his ability he intends to keep FNMA in operation. He looks upon it as a highly desirable outlet for mortgage loans in an interval of tight money, but Mr. Foley has also plainly said that that statement does not mean that Fanny May's buying activity will continue indefinitely and inevitably. What Mr. Foley says might be construed as a sort of caveat emptor for the lender who in such times as these commits himself unduly by relying on the supposedly assured continuation of the present FNMA market.

There is much conjecture on Fanny May's exposure. The Mortgage Bankers Association made a survey of its members as of May 1, at the request of Mr. Foley, in an effort to find out how many mortgages were outstanding or were going to be outstanding that could be sold to FNMA. The 600 replies received by the MBA showed a total of only $150-odd million . . . not an especially significant figure except that it strongly suggests that previous guesses of $500,000,000 and more on Fanny May's exposure were cockeyed.

At the present time Fanny May has funds amounting to $1,100,000,000, but of these funds $350,000,000 are earmarked for housing in defense areas. This leaves a net of about $750,000,000 for its regular program and indicates that there is no clear and present danger that FNMA will run out of money.

With the mortgage market in a state of tension and turmoil mortgage lending as it exists today is a business of confusion and uncertainty. Moreover, FHA and, particularly, VA programs are in an advanced stage of disruption as the government chooses to ignore the position of the financial market and assumes that interest rates can be established and maintained by edict. However, some of the mortgage cognoscenti hold to the firm opinion that within the next year the whole situation will work out and that the mortgage market will stabilize. I am not that sanguine. For my part calling now what's ahead for mortgage financing is about as simple as naming the colors in a spinning pinwheel.

The skids are greased for eased down payments under Regulation X in all areas of the United States. The bill authorizing the mayhem of the regulations was signed by President Truman on September 1. In the present national emergency, with inflation riding our flanks, it is a great mistake to relax the restrictions of Regulation X. X.

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